CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 275

November 2, 1964

BASIS: ACQUISITION DATE – NONTAXABLE DIVISION OF COMMUNITY PROPERTY

Syllabus:

Taxpayer's wife died in 1949, leaving an estate consisting of an undivided one-half interest in what had been community property owned by herself and taxpayer. The assets of the estate were in the form of securities, receivables and land. The decedent's will left her interest in the property to a research foundation subject to the payment of a bequest to her son.

Thereafter, within the year 1949, taxpayer and the foundation entered into a series of agreements to divide the property equally between them on the basis of fair market value at the date of decedent's death. Some items of property went entirely to taxpayer and others went entirely to the foundation; some of the homogeneous items, such as a block of shares in one corporation were divided equally between the parties and others were divided unequally. The division of property was subsequently approved by the probate court in its decree of final distribution.

We attempted to tax the division as a sale, exchange or other disposition of assets. Taxpayer appealed such action to the State Board of Equalization. In its decision the State Board of Equalization found that the transaction was a nontaxable division of property in the nature of a partition. During the years 1950 through 1954 taxpayer sold some of the assets he received as a result of the nontaxable division.

If a nontaxable division of community property of a husband and his deceased wife takes place between the husband and the beneficiary under the wife's will:

(1) What is the husband's basis for each asset he received and

(2) What is the husband's date of acquisition.

(1) In order to determine basis and date of acquisition an analysis of an appeal decision of the State Board of Equalization is necessary. The effect of the Board's decision is that the implementation of the partition agreement was merely an application of the provisions of the decedent's will. A study of the decision and the cases on which it is based shows that no transfer occurred and that the theory that each spouse has an undivided one-half interest in each item of community property (the item theory) is inapplicable in a partition

situation. In addition, language in two of the three Federal cases on which the Board decision is based leads to the same conclusion. The following language from Franz R. Walz, Adm., 32 BTA 718, is quoted by the Board of Equalization.

> "Here there has been no sale or exchange of the property in question, but a division of the property. In Osceola Heard Davenport, 12 TCM 856, this type of transaction is referred to as "an actual partition of the property, though not in kind but in value."

Further in said appeal we argued in favor of the item theory on the basis of Dargie v. Patterson, 176 Cal. 714. Taxpayer argued against the item theory. The Board's decision can be construed to be a rejection of our position, although the Board did not mention the item theory in its opinion. Finally the decree of distribution of the probate court supports this view. Although the property was distributed in accordance with the terms of the partition agreement, the decree did not mention the agreement.

Thus, the conclusion to be reached is that no transfer took place and that the item theory of community property is not applicable in a partition situation.

Under the circumstances the basis of each item of property received by taxpayer cannot be the total of one-half the fair market value of that item at the date of death plus one-half the adjusted basis to the community. Such a finding would require application of the substituted basis provisions of the law. Unless there is both a transfer and an application of the item theory a substituted basis cannot be used.

The Tax Court in the case of Ann Y. Oliver, 8 TCM 403, 428, et seq., one of the cases relied on by the Board of Equalization in the Clayton appeal, held that the basis for each asset was the basis of that asset to the community. This is also taxpayer's position. This holding has been criticized in two articles. See Tax Law Review 19, 55 and 1956 So. Cal. Tax Inst. 675, 704.

The Tax Court's approach treats the transaction as a partition in determining taxability at the time the division of property occurs, but does not treat the transaction as a partition in determining basis. A more logical approach would be to allot to taxpayer a basis equal to taxpayer's basis for his one-half of the community assets. This is the conclusion reached in the articles cited above.

However, in apportioning the basis to each asset fair market value should not be used as the criteria. Fair market value and basis do not have a sufficient connection, especially after assets have been held for varying lengths of time. A particular asset could have a basis of zero because of depreciation and yet have a substantial fair market value.
Thus, the most logical method of determining basis is the allocation of the taxpayer's basis for his community one-half of the total properties in the ratio

which the basis to the community of each asset received by taxpayer bears to the total basis to the community of all the assets received by the taxpayer. This method of apportionment takes into account depreciation of assets. This approach resembles that used in partnership liquidations.

(2) Since taxpayer's basis for the assets is one-half the total community basis, his date of acquisition will be the date the community acquired the property.